VZCZCXYZ0032
RR RUEHWEB

DE RUEHBU #1028/01 1281511
ZNR UUUUU ZZH
R 081511Z MAY 06
FM AMEMBASSY BUENOS AIRES
TO RUEHC/SECSTATE WASHDC 4426
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/USDOC WASHDCQ
RUEHRC/USDA FAS WASHDC 2165
RUEHC/DEPT OF LABOR WASHDC
RHMFISS/HQ USSOUTHCOM MIAMI FL

UNCLAS BUENOS AIRES 001028

SIPDIS

SIPDIS

PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
TREASURY FOR DAS LEE, RAMIN TOLOUI AND CHRIS KUSHLIS
NSC FOR SUE CRONIN
AND OCC FOR CARLOS HERNANDEZ
USDOC FOR ALEXANDER PEACHER
USDOL FOR ILAB PAULA CHURCH AND ROBERT WHOLEY
USSOUTHCOM FOR POLAD
OPIC FOR GEORGE SCHULTZ AND RUTH ANN NICASTRI

E.O. 12958: N/A
TAGS: EFIN ECON ELAB ALOW AR
SUBJECT: Argentina Economic and Financial Weekly for the week ending May 5, 2006

------------------------------------------------ --------
Weekly Highlights
------------------------------------------------ --------

- CPI rose 1.0 percent m-o-m in April - slightly above market expectations. PPI rose 1.5 percent m-o-m.
- Bolivian President Morales guarantees that Bolivia will sell gas at reasonable prices.
- The GOA successfully auctions off USD 500 million of Bonar V bonds.
- Tax revenues increased only 8 percent y-o-y to ARP 10.0 billion in April - below expectations.
- March trade surplus of USD 814 million - in line with expectations.
- Commentary of the Week: "Dollars from Foreign Trade: How Long will the Abundance Last?"

------------------------------------------------ --------
CPI rose 1.0 percent m-o-m in April - slightly above market expectations. PPI rose 1.5 percent m-o-m.
------------------------------------------------ --------

¶1. The Consumer Price Index (CPI) increased 1.0 percent m-o-m in April, slightly above market expectations of 0.9 percent, following a 1.2 percent m-o-m increase in March. Last month's increase brought inflation to 3.9 percent in the first four months of the year, compared to a 4.5 percent increase in the same period last year. CPI core inflation was up 0.68 percent, while the seasonal and regulated components of the index increased 0.27 percent and 0.03 percent, respectively. The categories with the highest increase in prices were clothing (+5.5 percent), leisure activities (1.5 percent - due to the Easter holiday break), housing (1 percent) and other goods and services (1 percent). Meat prices (representing 4.5 percent of the consumer basket) decreased 0.6 percent m-o-m due to the price restraint agreements between the GOA and the meat sector along with the ban on beef exports. Year-on-year, CPI rose 11.6 percent. The BCRA consensus survey forecasts 12.0 percent inflation in 2006, unchanged from last month's forecast. The 2006 Budget projects a 9.1 percent

inflation rate for 2006 and the Central Bank's inflation target range is 8-11 percent.

¶2. Producer prices jumped a strong 1.5 percent m-o-m in April, due to a 4 percent increase in primary goods prices and a 0.7 percent rise in the prices for manufactured goods. The price of electricity remained unchanged, while prices for imported goods increased 0.6 percent. The PPI index increased 11.0 percent y-o-y.

--------------------------------------------- --------
Bolivian President Morales guarantees that Bolivia will sell gas at reasonable prices.
--------------------------------------------- --------

¶3. After meeting for more than two hours on May 4, the Presidents of Argentina, Brazil, Bolivia and Venezuela agreed on a final document in which they supported Bolivian President Morales' decision to partially nationalize its energy reserves, and committed to renegotiate the price of natural gas supplied to Brazil and Argentina. However, the document leaves the actual price -- as well as investment decisions -- to be negotiated on a bilateral basis. The statement also highlighted the need to preserve and guarantee gas supplies and to stimulate a balanced development between producer and consumer countries. [Argentina currently imports 5 percent of its gas consumption from Bolivia at a "solidarity" price of USD 3.20 per million cubic meters, while the international price ranges from USD 2.00 to USD 8.00 per million cubic meters.]

--------------------------------------------- --------

GOA resolutions on electricity sector fail to materialize.
--------------------------------------------- --------

¶4. On May 4, local media reported that the GOA would soon publish two resolutions affecting electricity consumption and supply. The first resolution reportedly would eliminate the existing reward program for users who reduce their electricity consumption (compared to their consumption the previous year) and replace it with a penalty system for users who increase their electricity consumption. (Low-level consumers would be exempted from this program.) The second resolution would try to increase the supply of electricity by encouraging self-generating companies to add their supply to the wholesale electricity market. However, on May 5, newspapers reported that the GOA halted the publication of the resolutions (which would bring them into effect) because of their likely impact on inflation.

--------------------------------------------- --------
The GOA successfully auctions off USD 500 million of the Bonar V bond.
--------------------------------------------- --------

¶5. On May 3, the GOA announced that it would issue another USD 500 million of USD-denominated bonds, known as the "Bonar V," maturing in 2011. In its second auction, the GOA received bids for USD 2.4 billion, almost five times the auctioned amount. This allowed the GOA to set a yield of just 8.09 percent -- below the 8.36 percent set at the first Bonar auction on March 22 and below the 8.18 percent the bonds yield in the secondary market. [The Bonar V will amortize principal at maturity while paying interest every six months. The interest coupon was fixed at 7 percent per year in US dollars, paying 3.50 percent of nominal value.] According to GOA data, Deutsche Bank and JP Morgan accounted for 88 percent of the bids, with purchases of USD 365 million and USD 73 million,

respectively. Reportedly, the strong demand for the bond may encourage the GOA to advance a third auction of the Bonar for an additional USD 500 million later this month, and also to consider issuing a 10-year bond later in the year. With these expected Bonar issuances, along with the issuance of Boden 2012's to Venezuela and a new international bond issue (under U.S. law) for a total of USD 3.5 billion, the GOA will not only have met its 2006 financial needs but also pre-financed some of its 2007 financial needs, estimated at USD 2 billion by analysts.

---

Tax revenues increased only 8 percent y-o-y to ARP 10.0 billion in April -- below expectations.

---

¶6. April federal tax revenues increased only 8 percent y-o-y to ARP 10.0 billion -- well below market expectations of ARP 11.5 billion. The worse-than-expected tax revenue is mainly attributed to two changes in the tax regime: the increase in income tax deductions and the postponement of the income tax-collection deadline until May. Meanwhile, labor contributions rose 54 percent y-o-y due to increases in formal job creation and salary increases, while VAT revenues increased 19 percent y-o-y. Income tax revenues dropped 30 percent y-o-y while trade tax revenues decreased 4 percent y-o-y as a result of lower grain and energy exports. In real terms, revenues decreased 3 percent y-o-y. Despite the disappointing April result, tax revenues reached ARP 42.1 billion in the first four months of the year -- ARP 2.5 billion above the target (a 21 percent y-o-y increase). The BCRA consensus survey forecasts 2006 tax revenues at ARP 142.4 billion.

---

GOA to renegotiate its Paris Club debt.

---

¶7. On May 4, Cronista Comercial reported that the GOA will engage in negotiations to renegotiate its Paris Club debt in the second half of the year. As of December 2005, Paris Club debt stock (including arrears) reached USD 6.4 billion. The GOA reportedly will seek refinancing over thirty years, with no principal reduction but at interest rates below those paid before the GOA default. The GOA's goal is to gain access to new bilateral credit lines to finance infrastructure projects.

---

March trade surplus of USD 814 million -- in line with expectations.

---

¶8. The March trade surplus reached USD 814 million, in line with market expectations of USD 804 million. Exports increased 16 percent y-o-y to USD 3.5 billion, maintaining the steady growth of the last two months with increases in both price (+6 percent) and quantity (10 percent). Exports were driven by an increase in fuel and energy (+21 percent y-o-y), agro-industrial products (+21 percent y-o-y), industrial goods (+13 percent y-o-y) and primary goods (+6 percent y-o-y). Imports increased a strong 24 percent y-o-y to USD 2.7 billion, showing strong domestic demand, with increases in both quantity (+18 percent) and price (+5 percent). Imports were driven by increases in accessories for capital goods (+25 percent), passenger vehicles (+58 percent), consumer goods (+31 percent), capital goods (+32 percent), fuel and oil (+29 percent) and intermediate goods (+12 percent). According to the BCRA consensus survey, the trade surplus is expected to narrow to USD 10.1 billion in 2006 compared to USD 11.3 billion in 2005.

------------------------------------------- --------
April labor demand index up 1.0 percent mom -- first increase in five months.
------------------------------------------- --------

¶9. The April labor demand index calculated by Di Tella University increased 1.0 percent mom to 111.54 points, the index's first increase in five months and bringing the index almost back to where it was in November. The increase is mainly due to stronger demand for employees in the service sector (up 7 percent) followed by commercial personnel (up 4 percent) and technical employees (up 2 percent). The index is up 12 percent y-o-y. [The index is based on comparisons of job vacancy announcements printed in the two largest newspapers of the country.]

------------------------------------------- --------
BCRA President sees no risk of an inflation spike and praises the BCRA's sterilization policy.
------------------------------------------- --------

¶10. In his speech at the annual Council of the Americas conference on May 3, Central Bank President Martin Redrado said that there is no risk of a spike in inflation given the solid fiscal and monetary policies that anchor prices. He estimated that 2006 inflation will be within the 8-11 percent band announced by the BCRA in its monetary program. He praised the BCRA's sterilization policy of issuing notes ranging from 30-days to 2 years, and of encouraging banks to prepay their discount lending to the BCRA, which he noted also helps to strengthen banks' net worth.

------------------------------------------- --------
Banks pay back ARP 141 million in rediscount loans to the BCRA.
------------------------------------------- --------

¶11. On May 3, three banks (Banco Galicia, Banco Provincia and Banco Bisel) repaid ARP 141 million in discount borrowing to the BCRA. This prepayment repays the BCRA for financial assistance received during the 2001 financial crisis. Following these payments, the financial system will have outstanding discount borrowing from the BCRA, totaling ARP 6.0 billion --compared to ARP 21 billion at the beginning of the crisis.

------------------------------------------- --------
BCRA rolls over its maturities.
------------------------------------------- --------

¶12. The BCRA received ARP 1.3 billion in bids at its May 2 Lebac and Nobac auction, compared to the ARP 629 million in Lebacs that came due during the week. The yield on the 35-day Lebac decreased slightly from 6.60 percent to 6.57 percent, while the yield on the 63-day Lebac reached 6.85 percent and the yield on the 91-day Lebac reached 7.08 percent (the two latter Lebacs were not issued last week). Lebacs for maturities of more than one-year were withdrawn due to lack of interest. The spread on the one-year Nobac decreased thirty basis points from 2.50 percent to 2.20 percent, while the spread on the two-year Nobac also dropped thirty basis points from 3.70 percent to 3.40 percent. The Badlar rate (the base rate for Nobacs) is currently at 9.0 percent.

------------------------------------------- --------
Average time deposit increases to 67 days; private sector credit maturities increase to 268 days.
------------------------------------------- --------

¶13. According to BCRA data, the average length of

time deposits had increased to 67 days in December 2005, compared to 35 days in June 2003, its lowest level following the 2001 financial crisis. The increase in the average life is due to time deposits from institutional investors -- mainly pension funds (AFJPs) -- and the surge of instruments adjusted by CER (CPI-linked index), which by regulation cannot have maturities of less than one year. However, banks still face funding problems since time deposits maturities are still shorter than the credit maturities offered to the private sector. The average maturity of credit to the private sector had increased to 268 days in December 2005, compared to 95 days in June 2003.

---------------------------------------------- --------
The peso was unchanged against the USD this week, closing at 3.06 ARP/USD.
---------------------------------------------- --------

¶14. The peso remained flat versus the USD this week, closing at 3.06 ARP/USD. The BCRA's strong intervention in the foreign exchange market this week prevented the peso from appreciating due to the large dollar sales by exporters from the harvest season. The BCRA purchased USD 301 million in the FX market in the first four days of the week, with a record high purchase of USD 109 million on May 2. The peso exchange rate has depreciated 0.3 percent since the beginning of the calendar year.

---------------------------------------------- --------
Commentary of the Week: "Dollars from Foreign Trade: How Long will the Abundance Last?, by Jorge Vaconcelos. (Note: from an article published on April 6 in El Cronista Comercial. End Note.)
---------------------------------------------- --------

¶15. All indications are that during the first quarter, aggregate demand will continue driving the Argentine economy. The wage base, driven by

increasing employment and increasing salaries, along with the expansion of credit, will provide all the fuel needed. While many observers have noted that these trends could push inflation above the official estimates -- now at 11 percent for 2006 -- one can also outline a "third position," focusing on the external sector: that the trade surplus could fall unexpectedly rapidly if local supply (which is dependent on investment) cannot keep up with the increase in demand.

¶16. Perhaps because the 2005 trade surplus was USD 11.3 billion, many people believe that the abundance of dollars coming into the local market from foreign trade is here to stay. Nevertheless, to consolidate this new situation, we will have to deepen the "exporter bias" of the economy, given that, as we will see, the exchange rate alone will not be sufficient to maintain the surplus.

¶17. At the outset, it is helpful to keep in mind that the performance of the Argentine external sector in recent years has not been extraordinary: exports have followed the worldwide trend, and imports have recovered at a good pace after they contracted sharply during the 2001-02 crisis.

¶18. The record exports we experienced in 2005, reaching USD 40 billion, occurred in an external environment that was particularly favorable to trade. From 2000 to 2005, Argentine exports increased 52 percent. That sounds impressive at first, but not when put in the context of worldwide exports increasing 60 percent in the same period. In fact, Argentina's share of world exports decreased slightly

in the past five years, from 0.41 percent to 0.39 percent. Contrast this trajectory with that of Brazil, which increased its exports 115 percent in the same period, and increased its world market share from 0.86 percent in 2000 to 1.16 percent in 2005.

¶19. In addition to looking at this in the context of exports, it is useful to disaggregate the trade surplus into its principal parts: on the one hand, the external balance of the petroleum and fuels sector, which totaled USD 5.4 billion in 2005; and on the other hand, the trade surplus from manufacturing and agriculture, which totaled USD 5.9 billion.

¶20. Concerning the fuels segment, the current trend of a 4 to 5 percent annual decrease in production of petroleum indicates a reduction in the trade surplus of USD 1 billion per year. To prevent this reduction of the surplus, it would require either that the price of a barrel of oil continue rising or that the domestic situation changes completely and investment in exploration and production doubles. The latter is probable, but we cannot count it until it actually starts to happen.

¶21. In regard to the trade balance for the non-petroleum segment, we had a 2005 surplus of USD 5.9 billion. An important amount, but lessened by two factors: (1) the trend, and (2) its significance in comparison to manufacturing and agricultural activities.

¶22. The trend of the trade surplus from the non-petroleum sector: In the first two months of 2006, the quantities exported from the non-petroleum sector increased 7 percent. Price increases added another 6 percent, for a total increase of 13 percent. Looking only at quantities and extrapolating from the first two months to the rest of the year, non-petroleum exports should reach USD 35.3 billion, and due to price factors perhaps they will increase an additional USD 1 billion. What is happening with imports at the same time? In the first two months, purchases from abroad (excluding fuels) increased nearly 24 percent,

meaning that if this trend continues until the end of 2006, imports will reach USD 33.7 billion. The non-petroleum trade surplus would then total just USD 2.5 billion, after reaching USD 5.9 billion in 2005. But non-petroleum export prices threaten to stall in the latest data and, even more importantly, imports could surge even more, driven by domestic demand.

¶23. Foreign trade versus the value added by manufacturing and agriculture: non-petroleum exports, which last year totaled USD 33 billion, represent 60 percent of the valued added by industry and agriculture, a number that is necessarily limited in a relatively small country such as Argentina. Furthermore, this percentage has remained the same for the past four years. On the other hand, non-petroleum imports represented 50 percent of the value added by industry and agriculture. What is notable is that, despite the current exchange rate, the share of imports is 5 percent above the share of imports in ¶1998. This data could be indicating a tendency for manufacturing to specialize, but it also indicates that local supply cannot keep up with the growth in demand, and that imported products are filling the gap (despite the 3-to-1 exchange rate). (Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.)

GUTIERREZ